RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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June 18, 1980 **LETTER 785**

June 6, DJIA 861.52; PTI 1194; A-D ratio −19.71
June 13, DJIA 876.37; PTI 1223; A-D ratio −18.79

THE PICTURE: Times have changed. The myriad problems of the 1970's and the ongoing problems of the 1980's have forced most Americans to become amateur economists. The level of economic sophistication has risen tremendously, both on Wall Street and on Main Street. Wherever you go today you hear people talking about inflation, money supply, the stock market, the gold market, art, collectibles, the meaning of what the Fed is doing, etc.

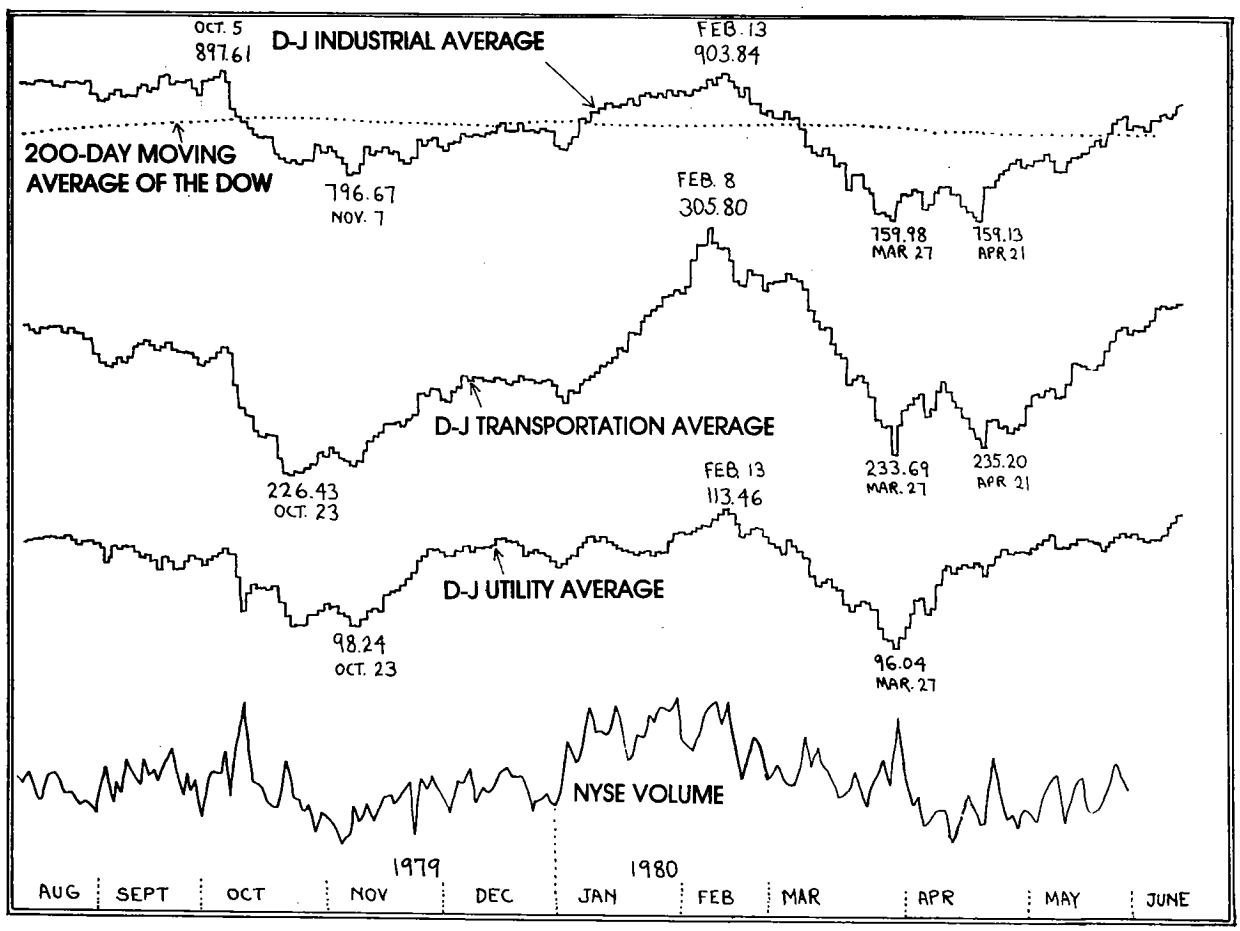
Billions of dollars are now being "run" by many hundreds of sophisticated professionals. Like any group pursuing the same ends (in this case, trying to make money) the professional money managers watch the market with one eye—while they watch each other out of the other.

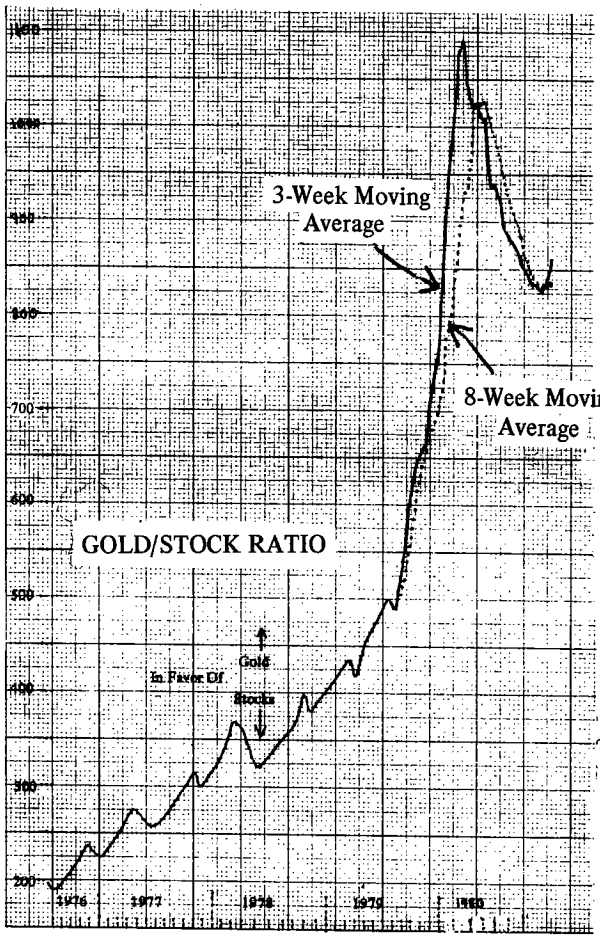
It's obvious that what the money managers are trying to do now is buy the stock market at bargain prices as the news turns bad. In so doing, they hope to be "jumping the gun" on the ultimate turn (to the upside) in the economy. The question, of course, is, "Has the market discounted too much, too soon, or did we, in fact, see the market lows in late-March?" At this time, I have no strong feeling either way. I do have a nagging suspicion that the pros may be playing the market a little too cute—but that's only a suspicion, not a deep-seated conviction.

FRONT PAGE COMMENT: What we've been seeing on the NYSE and AMEX is basically a red-hot oil market. So you ask, "Why a hot oil market in the face of an oil glut?" The answers are (1) investors are buying the oils because of a possible (I say probable) cut-off of the Mideast oil by the Russians. (2) Oils are being bought because of the steady rise in the price of OPEC (and all other oil and oil products). (3) Investors are buying the oils because oil, like gold, is an asset and an alternative to paper money. With the recession in full bloom, knowledgeable investors know that the coming Federal deficits are going to be huge. Add to this a probable tax cut, and you get the next round of potential monetary inflation.

In the last Letter I presented my case for all readers holding basic positions in gold (in the form of gold coins). I believe gold is in an important buying range now. In the next Letter I am going to present an extraordinary study of gold with conclusions that point to the development of a bull market third phase by no later than mid-1982. This study will be of vital interest to all subscribers.

My own guess is that there will be time during the summer or fall to buy stocks, and there may well be a safer and clearer bottom than the one that appeared during March. Meanwhile, the US economy is in a free-fall, and the *Business Week* Index





has dropped 13 weeks in a row. The fact is, this business decline is not like 1974-75: in many ways it is worse! Which is OK from a stock market standpoint, but I am nevertheless very curious to see how matters develop during the summer and fall. The consensus is that "it's only a matter of picking which month the recession bottom will fall on," be it July, August or December. It all seems dreadfully "pat" to me, but then I must allow for my own inclination towards "healthy skepticism."

At any rate, the stock market cycle, as I chart it, is scheduled to continue in a bull phase until August, and what I am particularly interested in is whether this bull cycle (which started in March) can carry the Dow above its peak of the last bull cycle (that peak was 903.84 recorded on February 13), along with a Transport peak of 305.80 recorded February 8.

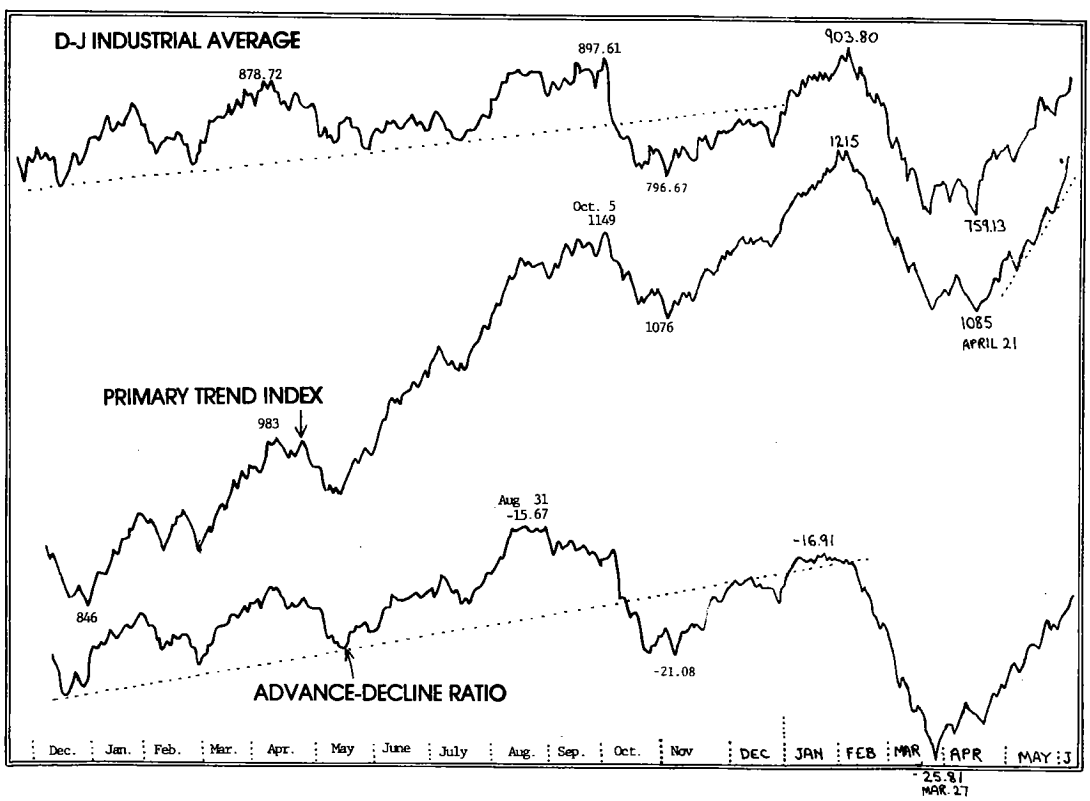
The page 1 chart of the Averages paints a clear and obvious picture of the technical problem which now confronts the market. The Industrials have now recouped about 75% of their February-March losses while the Transports have recovered about 63% of their own losses. This leaves us wondering whether the current rally is just another voyage through the 1977-79 trading range–or the beginning of something more important. Only time (and probably the next correction) will tell.

* *

To my mind, the most important chart of the day (at left) is this chart of the RATIO of common stocks to gold. I mentioned in the last Letter (along with the gold advice) that my gold/stock ratio was very close to giving a "buy signal" in favor of gold. On Thursday, June 5, I received this buy signal–and I want to discuss that now.

The ratio I use is obtained by dividing the Thursday price of gold by the Thursday price of the NYSE Composite Index. I run these weekly ratio numbers on a 3-week and an 8-week moving average (see chart). When the 3-week ratio is above the 8-week ratio it tells me that gold is outperforming common stocks and that I should be in gold. When the 3-week MA is below the 8-week MA the chart is telling me that stocks are outperforming gold, and in that case holding common stocks is more profitable than holding gold.

As you can see, the ratio said "hold gold" from 1976 up to early-1980. The 3-week MA then dropped below the 8-week MA as both MA's headed down, and the chart was saying that if you hold anything it should be stocks, not gold. On June 5, 1980 the 3-week MA crossed above the 8-week MA, and the cold, remorseless verdict of the gold/stock ratio was that you should again switch to gold. This is not to say that stocks cannot go up, but it is saying that the more profitable position is gold. And that, readers, is where we are now (i.e., with an increased position in gold).



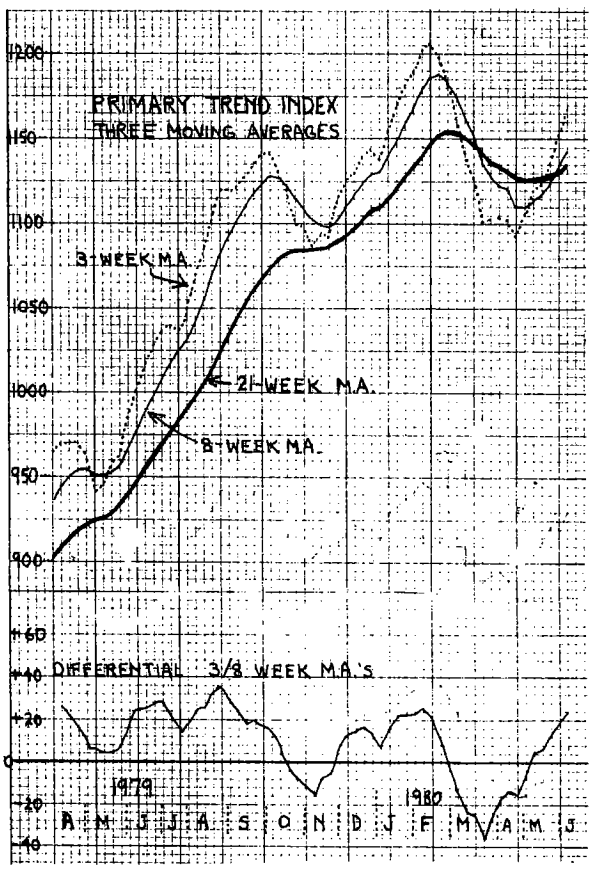
I want you to understand that I am not *prejudiced* against stocks in favor of gold. I assume that we are all trying to maintain or increase our purchasing power, and frankly, I couldn't care less whether we do that by holding Treasury notes, gold, stocks, bonds or anything else. As of June 5 the ratio says "Gold" and if that changes I'll let you know–fast.

Next, please turn to the daily chart (bottom of page 2) of the Dow, the Primary Trend Index (PTI) and the A-D ratio. The PTI on June 11 rose to 1217, **highest point** since I have been keeping this extraordinary indicator! The A-D ratio is not quite as strong, being about 2 full points below its January 28 peak and over 3 points below its peak of last August. The Dow has about 30 points to go in order to better its February peak.

I believe the PTI is the most useful of the indicators here. A continued climb by the PTI will (as it always does) drag the market and everything else along with it. The non-confirmation (i.e., the new high in the PTI unconfirmed by the Dow) indicates that the market is tired and that it may need a rest before it can follow the PTI to higher ground. But it is the basic trend-direction of the PTI which is so important here. And the critical thing to remember is that no major decline has ever developed while the PTI was in a **persistent** and continuing uptrend. To get weakness, the PTI has to turn decisively down! Along these lines, I believe the next section should prove to be invaluable.

NEW STUDY: I titled the opening page of the last Letter "Jerked Around" because I believe that this is to be the fate of the US and its economy from here on–until such time as the whole situation runs out-of-control and the natural forces in the economy loom larger than any new manipulations that our Government can come up with. **Volatility** in the commodity markets has always been considered normal. Volatility in the stock market has become the accepted norm. Most recently the bond markets have entered the world of volatility. Finally, the precious metals have also become volatile items (as have the various currencies).

In regard to the stock market, I've been doing a lot of thinking about what kind of procedure might help my subscribers most. And I've come to this conclusion. I think the thing that helps me most, and therefore what might help my subscribers most, is a reasonable, reliable *frame-of-reference* regarding the overall market trend.



For this, fortunately, I have my Primary Trend Index (PTI). Unfortunately, up to now I have not been making the best use of this very valuable index. I want to correct that now.

I invented the PTI back in 1971 following many years of trial and error. And to date I've had 10 years of experience with the PTI. Subscribers have also watched the movements of the PTI month after month, and they are in an excellent position to judge its usefulness and accuracy. The fact is that it works! I would say that most of my own mistakes over the past decade have come either from ignoring the PTI, arguing with it, or not giving it enough credence. And that's what I want to center on now.

Since late-1978 I have run a chart of the PTI on the basis of three sensitive (i.e., exponential) moving averages (MA's). I use a 3-week MA, an 8-week MA and a 21-week MA. These three MA's can be most useful in *classifying* the trend of the PTI and therefore also the underlying trend of the market.

Starting with this Letter I will term it a trader's market whenever the 3-week MA of the PTI is above the 8-week MA. I will call it an important buy whenever the 8-week MA is above the 21-week MA. Conversely, I will call it a sell area when the 3-week MA is below the 8-week MA. I will call it an all-out sell zone whenever the 8-week MA drops below the 21-week MA.

This procedure accomplishes a number of things. First, it will tend to put traders and investors on the right side of the market and give them a frame of reference which will cut through all the news, the propaganda, the fear and the nonsense. Second, it will give us signals that are not based on any single, widely-followed indicator. Third, it will show us whether the market is building or losing technical strength (this can be based on the direction of the sensitive 3-week MA).

I think the accompanying chart is self-explanatory. The dotted line is the 3-week moving average of the PTI, the thin black line is the 8-week MA, and the heavy black line is the 21-week MA. The differential line at the bottom of the chart is the differential between the 3-week and the 8-week MA's.

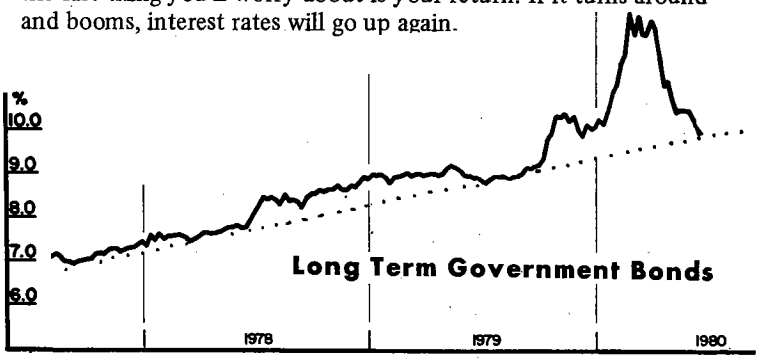
The direction of the 21-week MA (the longest MA) is obviously very important in gauging the strength or weakness of the market. The 21-week MA hit a low on May 18, but the 21-week MA is now rising. On a more sensitive basis, the short-term or 3-week MA hit its low on March 27, and it has been rising ever since. On May 8 the 3-week MA rallied above the 8-week thus giving a trading buy signal. On May 29 the 8-week MA rose above the 21-week MA putting the whole PTI syndrome into the bullish mode.

At this point the MA study was telling us that the broad trend of the PTI was up as was, of course, the broad underlying trend of the market as well. I debated at the time whether to emphasize this phenomenon or whether to stress gold. For the fact was that both the trend of stocks and the trend of gold was bullish. But with my gold-to-stock ratio giving a bull signal in *favor of gold*, I decided to stress the gold situation for the purpose of new buying. For as long as the gold/stock ratio continues to rise, the greatest profits will accrue to those who hold gold. Nevertheless, the PTI study says that the trend of the stock market is bullish, and it is simply the relative strength of gold which is in the more important bull trend.

HOWEVER, I intend to give full attention from here on to the moving average study of the PTI. In this way, I hope to be able to keep subscribers on the right side of both the stock and the gold markets. To this add my comments on the money markets, and I believe (at least I hope) that Dow Theory Letters will have added importance to you as a student of the markets and as an investor.

MONEY MARKETS: We got into the interest rate move at the beginning. Some subscribers took half profits on their T-note and 5-year bond positions, some took all their profits and others are still holding. Today's collapse in interest rates is a function of the collapse of borrowing. Suddenly, everybody is wondering what to do with their money. My answer–stop worrying. Whether you make 6% or 16% on your rollovers is not going to make or break you. You have (or took) nice profits, so now look to the next item.

As for the money instruments, they look as if they are going still higher (with interest rates still dropping). But now, *everybody knows* that the trend is down for interest rates, and I would guess that the "easy pickin's" are over. If you don't know what to do with your new money, buy the T-bills. If the economy collapses, the last thing you'll worry about is your return. If it turns around and booms, interest rates will go up again.



NOTES & QUOTES: There's no shortgage of debt creation in the US. In an article entitled "Financial Crunch for States and Cities," Dunn's Magazine (June) notes that in a survey of 302 cities it is revealed that the percentages of these cities running deficits was 30.3% in 1978, 45.5% in 1979 and the percentage is expected to rise to 56.3% this year. That's progress!

* *

A recent poll (from Parade Magazine) indicates that people still vote via their pocketbooks. Asked "What do you think is the most important problem today?" 74% of Americans listed "High cost of living", 17% listed "International problems," 8% listed "Energy problems" and 4% listed "Unemployment."

* *

Someone besides me is worried about the Russians and the state of the US defense capabilities. In the July issue of Penthouse (of all places) one can read two excellent articles: (1) "Russia's Plan for Taking Over the Middle-East" by a former Soviet diplomat, and (2) "Unready and Willing" by Ernest Volkman, an article about what's left of our armed forces.

I include these two little gems which I clipped out of this week's newspapers. They don't make for happy reading (unless you happen to be Russian), but then I'm trying to deal with facts and the truth, rather than "soothing syrup."

* *

The American Economic Council is holding a major conference in Beverly Hills on August 7-10. The Conference promises to be a whopper, and it's coming at a very critical time. Speaking among others will be Jim Dines (who is predicting a major deflation and higher gold and silver), Jim Sincalir (who wowed 'em in Montreal), Nicholas Deak (the Deak in Deak-Perrera), Howard ("Best seller") Ruff, Franz Pick (who is still very unhappy about paper money), Jerome Smith, and I will be speaking too. Not only will you see and learn a lot at this Conference, you'll see how the super-rich work and play and shop in yummy Beverly Hills. Call the AEC (213)550-6394 or write 9301 Wilshire Blvd., 7th Floor, Beverly Hills, CA 90210. These conferences give me a chance to see the country and many of my friends in this business and also to meet many of my subscribers (in Montreal I asked for a show of hands from Dow Theory Letters subscribers and fully 1/3 turned out to be my readers–I was amazed).

NEW SOVIET TANK MENACE REPORTED

LONDON (AP) — The Soviet army's main battle tanks in Eastern Europe, the T-64 and the T-72, are protected by armor effective against the guns and missiles currently in NATO's armory, the British Press Association news agency reported yesterday.

The agency, quoting government sources, said the laminated armor — layers of various substances — was developed simultaneously with Britain's new Chobham tank armor, but is said to be different in concept.

These Soviet tanks present a "massive threat in both quality and quantity," the association quoted the sources as saying.

WASHINGTON — The Soviet Union has sent its new battle cruiser Kirov, the world's largest nuclear-powered warship save for three U.S. aircraft carriers, to sea for its first trial runs, Pentaon sources said yesterday.

The sources said the 800-foot-long cruiser had a standard displacement of about 22,000 tons. This would mean that, at full load, it would displace close to 30,000 tons.

The largest non-carrier nuclear surface warship in the U.S. fleet is the 19-year-old cruiser Long Beach. It displaces 17,100 tons at full load.

A Navy spokesman said the Kirov "bristles with missiles," being armed with a new-generation, long-range anti-ship cruise missile, two anti-air missile systems and a dual-purpose gun for bombardment.

BACK: I'm back from Montreal after delivering my talk at the National Committee for Monetary Reform. And as always (I'm embarrassed to say this) I'm very happy to be back in Southern California (I felt better as soon as we crossed the Rockies). I stopped off to spend two days in NYC, and as an ex-New Yorker I must say that I was struck by the City's "falling apart" look. Sad to say my old home town is showing the ravages of time, vandalism, bankruptcy, huge low-income minorities and general over-population.

Is this the town where I grew up? In some ways yes, in other ways definitely not. Apartments are nowhere to be found, and if you do find one you pay–plenty. Everyone I talked to has a different complaint, from the cab drivers ("The holes in the streets are wrecking my cab") to the millionaire investors ("No amount of money can get this blasted garbage off my block").

I think it is the bags of garbage, the dirt in every street crevice, and the pieces of dirty paper strewn over the sidewalk that bothers me more than anything else. I'm really not a cleanliness nut, but I swear NYC is just ridiculous–it's just plain filthy.

The Picasso exhibit at the Museum of Modern Art was magnificent, one of the great art displays of the century. The crowds were immense, and I would have preferred to see the exhibit under more serene circumstances. But you can't have it all. And the restaurants, when it comes to restaurants you can forget about all the other cities. NYC is where the great food is; it's as simple as that.

Montreal, in contrast to NYC, is squeaky clean. Even though it's a big city (population, 1.5 million) you can eat off the Montreal streets. Montreal is populated by friendly, fun-loving,

easy-going people. Happily, as I walked the streets and jogged them in the early morning, I got absolutely no feeling of danger or hostility from the "street people." In fact, I would say that there is a striking absence of hostility, hooliganism and hustle in Montreal. The massive buildings, super deluxe Montreal shopping arcades and happy people reflected the enormous wealth of Canada (although people told me that the population trend is to *Western* Canada (just as the trend is here in the US).

I met many old friends at the seminar including Julian Snyder, Walt Bressert, the Blanchards (who put on the seminar) Tom Holt, Howard Ruff. I spent a lot of time with Mike Kaller (leading stamp expert and agent) and Judy Kaller (well-known coin expert, agent). They had just come back from Harry Schultz's seminar in the Bahamas and they were in a state of semi-shock. Harry had opened his seminar with a simulated "Carter speech" in which our President announces in great detail why he has surrendered the US to the Russians. Obviously, the speech had a powerful impact. It was Harry's way of presenting his dramatic analysis of the impending, growing, Russian threat.

I might add that Harry and I have been working with different sources of information, but we have both come very close to the same conclusion. Unless the current US path is reversed almost immediately, the consequences to the US and the free world are going to be catastrophic. I've known Harry for about 20 years, and take it from me Harry is no paranoid and he is no fool. If it takes startling showmanship to try to get across what's happening as the Russians build up their military might, then all I can say is, "More power to you, Harry." Somebody's got to wake this country and the free world up, and all informed people MUST do their part.

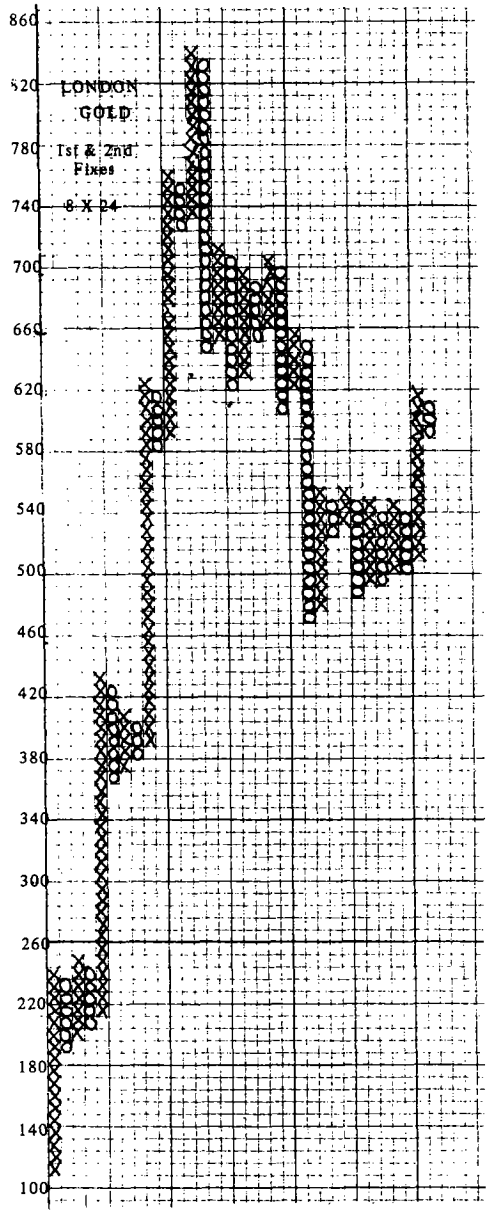
GOLD: During the 1976-79 bull market second phase advance in gold, there was widespread talk about "the end of the dollar" and the systematic "phasing out" of the dollar from the international reserve system. The "hard currencies" such as the German mark and the Swiss franc were then the preferred alternatives to the dollar.

But the game has changed. Due to high oil import prices, Germany and Switzerland now have rising balance-of-payments deficits. Moreover talk of the phasing out of the dollar has all but disappeared. The Arabs, despite threats of a "basket of currencies" for oil payments, are still taking in dollars; in fact they are taking them in larger quantities than ever.

This means that during the next round of world inflation (probably brought on by concerted attempts to re-stimulate the world economy) there are not going to be any preferred currencies. During the next inflationary binge, the only real money is going to be gold. When is the next world re-stimulation going to start? Soon, very soon; it is probably starting in the US now (via the Fed's (twice) lowering of the discount rate).

Gold during 1976-80 ran up from 103 to 850. In early 1980 gold dropped from 850 to 472, a loss of just about 50% of its 1976-80 gains. Towards the end of March gold entered into a major consolidation (the triangle seen on the gold chart). On 4 different occasions within the triangle gold broke below the 500 level. Each time buyers brought gold back above 500. During the week ending June 5 gold finally broke out of the triangle (above 560).

The 378 point loss of 1980 must be considered a full and sufficient correction of the second phase of the gold bull market. But

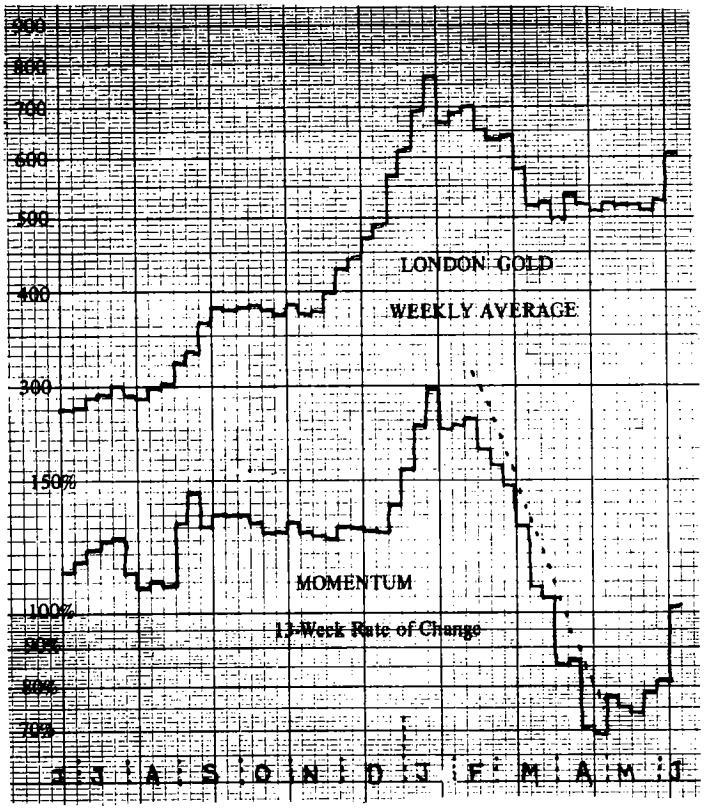


it is bullish that despite the violent drop, gold **retained 50%** of its 1976 to 1980 gains. Under the 50% Principle, gold is now technically entitled to move up and (in its own good time) re-test the 850 bull market high.

It is my opinion (expressed in the last Letter) that the second phase correction (850 down to 472) has now ended. Therefore, I consider gold to be in the EARLY beginnings of the third and final phase of the great gold bull market. I do not know how long this third phase of the bull market will last. Nor do I know how high gold will eventually go. However, I will venture to predict that gold will ultimately at least double its 850 second phase high price. I will predict that we will see (at some point) a world-wide panic into gold. I will predict that we will see one day when gold will rise by 150 dollars an ounce.

If the third phase of the gold bull market develops, as I believe it will, we will ultimately see a time when gold or real money will (like a giant vacuum) suck everything into its vortex. We will see a period when EVERYBODY wants to own some PHYSICAL gold. Such a rush may have the effect of knocking down all other prices such as stocks, bonds, "things" as they are sold for gold. I think we will see this occur before 1984.

Neither I nor anyone else can make money for you in the markets. All I can do is tell you what I think is going to happen.



If **YOU MOVE** and I am right, you will be ahead of the game. I think I am right. It's therefore up to you to move. I suggest that you move (if you have not done so yet) to buy gold in coin form.

People ask me whether the gold stocks should be bought. The answer is probably yes, but in the end, in the final analysis, I see gold stocks as good speculations. However, they will NOT TAKE THE PLACE OF GOLD COINS. Gold coins in your possession represent real ownership of real money. Gold coins represent ultimate ownership with no debt, no mortgage, no claims against it. The coins should make up your core position as an investor as we move into the third phase of the gold bull market. In the end, I am not convinced that people will trust a certificate saying that you own a share of a gold mine. I don't know how the gold mines will ultimately fare either here or in S.Africa. They'll probably do fine, and an easy way to buy them is through two gold funds, *International Investors* (122 E. 42 St., NYC 10017, a load fund) or *United Services Gold Shares*, (Box 2098, Universal City, TX 78148, a no-load fund). But it is the gold itself that I want my subscribers to own. The stocks are a sideline, a secondary consideration after your core position in Maple Leafs, Krugerrands or Coronas.

This week gold momentum took a big jump to 104, and it is therefore plus (i.e., over 100) for the first time since the reaction low. This is another way of saying that gold is now **above** its price of 13 weeks ago, and this is, of course, a positive sign for gold.

Also this week the 5-week moving average of gold (see last Letter's chart) advanced ABOVE the 13-week moving average. The three gold MA's are now in the bullish position, with the 5-week MA above the 13-week MA and the 13-week MA above the 50-week. The values of the three MA's are as follows: 5-week is 565, 13-week is 549, and the 50-week MA is 479.

Final Conclusion: The trend of common stocks is bullish with the PTI leading the way. BUT the trend of gold is stronger than stocks on a relative strength basis. Therefore, your major position should now be in gold. Domestic oil shares should be a good investment, certainly a good hedge on any disaster that might emerge from the Middle-east situation. Mesa Petroleum, American Quasar, Dome Petroleum, Superior Oil are all important Western producers. The trend is to both black and yellow gold.

I'm going to end this gold section with a paragraph written by Felix Rohatyn, senior partner in Lazard Freres and Chairman of NYC's Municipal Assistance Corp. This quote (from New York Magazine, June 16) hints at the tremendous strain in our financial system. When you understand the full meaning of this paragraph, you KNOW that something "has to give." It's only the timing that is the puzzle.

> First, in 1980 our payments to OPEC will approach $100 billion, nearly ten times what they were five years ago. The value of all companies listed on the New York Stock Exchange is about $900 billion. The notion that, over the next five years, we will mortgage to OPEC half of our productive capacity, built up over 200 years, to pay for a product we burn every day is obviously unsustainable. Recycling this wealth is not the answer; it is only a mechanism to lend more and more money to people who can afford it less and less. The industrialized free world and the Third World will each run a deficit of about $60 billion this year due to oil imports, with OPEC running a total net surplus of about $120 billion. Since all these oil-importing nations will need vastly stepped-up exports to cover these deficits, it is difficult to see who will export to whom. And in view of the strain on our banking system, it is difficult to see where the financing will come from.

PHILOSOPHY: I am always impressed by the amount of energy that the average investor expends in worrying about what he has done. "I should have sold sooner," "I should have held," "I'd be a millionaire if I had only done that." To which I say, forget it. The only good the past is–is to provide lessons. If you can learn something from what you've done in the past, good. But to bemoan wrong moves or moves that might have been is an enervating, demoralizing waste of time.

The really important thing to remember and the great thing about this business is–that THE MARKETS ARE ALWAYS THERE. So spend your energy thinking about what you are going to do NEXT, what opportunities are coming up, what looks good or could look good a week or a few months from now. Train yourself to ignore your past "screw ups" and to look to future intelligent, rewarding moves. Remember, from the market's viewpoint, the man who has lost $10 million and is down to his last $25,000 is in the same position as the man who has been very successful and has run a few thousand dollars up to $25,000. The market only cares about one thing–what is each of these men going to DO next?

NEXT MAILING: July 2